securities in the near future, participations in securities purchase plans, list of unpaid debts, and present income level. Some questions have been modified to facilitate understanding but no questions have been deleted. If additional inquiry is indicated by the answers on the form, a loan officer of the lender will interview the borrower by telephone to make sure the loan is ''non-purpose''. Whenever the loan exceeds the ''maximum loan value'' of the collateral for a regulated loan, a telephone interview will be done as a matter of course.

(d) Although the Board has expressed no views as to the necessity for face-to-face meetings between borrower and lending officer under Regulation G, an interpretation under Regulation U published in 1965 (12 CFR 221.115) on the subject has usually been considered applicable. That view, however, was expressed before the adoption by the Board of Regulation X (12 CFR part 224) in 1971. One of the stated purposes of Regulation X was to prevent the infusion of unregulated credit into the securities markets by borrowers falsely certifying the purpose of a loan. The Board is of the view that the existence of Regulation X, which makes the borrower liable for willful violations of the margin regulations, will allow a lender subject to Regulation G or U to meet the good faith acceptance requirement of §§ 207.1(e) and 221.3(a), respectively, without a face-to-face interview if the lender adopts a program, such as the one described above, which requires additional detailed information from the borrower and proper procedures are instituted to verify the truth of the information received. The 1965 interpretation has therefore been withdrawn. Lenders intending to embark on a similar program should discuss proposed plans with their district Federal Reserve Bank. Lenders may have existing or future loans with the prospective customers which could complicate the efforts to determine the true purpose of the loan. In addition, Regulation U differs from Regulation G in many important respects.

(e) Section 220.7(a) of Regulation T, in general, prohibits a broker/dealer from arranging any credit which he himself cannot extend. Therefore, the Board cautions that any prospectus of sales information for the mutual fund shares may not offer the services of the lending company, as any broker/dealer selling the fund shares would thereby be deemed to have ''arranged'' a loan in violation of Regulation T.

[43 FR 30038, July 13, 1978]

§ 207.111 Combined credit for exercising employee stock options and paying income taxes incurred as a result of such exercise.

(a) The Board of Governors has been asked whether § 207.1(h) of Regulation G prevents a lender under an employee stock option plan that meets the requirements of § 207.4(a) from extending credit to an employee to pay the income taxes incurred as a result of the exercise of the stock option, in addition to the credit to cover the purchase price of the stock.

(b) Section 207.1(h) prohibits a lender governed by Regulation G from extending purpose credit if it is secured by collateral including margin securities, which also secures any other credit to the same person in excess of $5,000. Unless credit to pay income taxes is also treated as purpose credit, it could not be extended in an amount in excess of $5,000 when the borrower also has a purpose loan outstanding with the lender, secured by margin securities, since such collateral would be deemed to be also securing the income tax loan. *Purpose credit* is defined in § 207.2(c) of the regulation as credit which is for the purpose, whether immediate, incidental, or ultimate, of purchasing or carrying a margin security.''

(c) Section 207.4(a), which provides special treatment for credit extended under employee stock option plans, was designed to encourage their use in recognition of their value in giving an employee a proprietary interest in the business. Taking a position that might discourage the exercise of options because of tax complications would conflict with the purpose of § 207.4(a).

(d) Accordingly, the Board has concluded that the combined loans for the exercise of the option and the payment of the taxes in connection therewith under plans complying with § 207.4(a) may be regarded as credit which is for

the purpose of purchasing or carrying a margin security within the meaning of § 207.2(c). Since the combined loans are treated as purpose credit, § 207.1(h) does not prohibit the transaction, irrespective of amount.

[45 FR 44256, July 1, 1980]

§ 207.112 Purchase of debt securities to finance corporate takeovers.

(a) Petitions have been filed with the Board raising questions as to whether the margin requirements in Regulation G apply to two types of corporate acquisitions in which debt securities are issued to finance the acquisition of margin stock of a target company.

(b) In the first situation, the acquiring company, Company A, controls a shell corporation that would make a tender offer for the stock of Company B, which is margin stock (as defined in § 207.2(i)). The shell corporation has virtually no operations, has no significant business function other than to acquire and hold the stock of Company B, and has substantially no assets other than the margin stock to be acquired. To finance the tender offer, the shell corporation would issue debt securities which, by their terms, would be unsecured. If the tender offer is successful, the shell corporation would seek to merge with Company B. However, the tender offer seeks to acquire fewer shares of Company B than is necessary under state law to effect a *short form* merger with Company B, which could be consummated without the approval of shareholders or the board of directors of Company B.

(c) The purchase of the debt securities issued by the shell corporation to finance the acquisition clearly involves *purpose credit* (as defined in § 207.2(l)). In addition, such debt securities would be purchased only by sophisticated investors in very large minimum denominations, so that the purchasers may be *lenders* for purposes of Regulation G. See 12 CFR 207.2(h). Since the debt securities contain no direct security agreement involving the margin stock, applicability of the lending restrictions of the Regulation turns on whether the arrangement constitutes an extension of credit that is secured indirectly by margin stock.

(d) As the Board has recognized, *indirect security* can encompass a wide variety of arrangements between lenders and borrowers with respect to margin stock collateral that serve to protect the lenders' interest in assuring that a credit is repaid where the lenders do not have a conventional direct security interest in the collateral. See 12 CFR 211.113. However, credit is not indirectly secured by margin stock if the lender in good faith has not relied on the margin stock as collateral extending or maintaining credit. See 12 CFR 207.2(f)(2)(iv).

(e) The Board is of the view that, in the situation described in paragraph (b) of this section, the debt securities would be presumed to be indirectly secured by the margin stock to be acquired by the shell acquisition vehicle. The staff has previously expressed the view that nominally unsecured credit extended to an investment company, a substantial portion of whose assets consist of margin stock, is indirectly secured by the margin stock. See Federal Reserve Regulatory Service ¶5–917.12. This opinion notes that the investment company has substantially no assets other than margin stock to support indebtedness and thus credit could not be extended to such a company in good faith without reliance on the margin stock as collateral.

(f) The Board believes that this rationale applies to the debt securities issued by the shell corporation described above. At the time the debt securities are issued, the shell corporation has substantially no assets to support the credit other than the margin stock that it has acquired or intends to acquire and has no significant business function other than to hold the stock of the target company in order to facilitate the acquisition. Moreover, it is possible that the shell may hold the margin stock for a significant and indefinite period of time, if defensive measures by the target prevent consummation of the acquisition. Because of the difficulty in predicting the outcome of a contested takeover at the time that credit is committed to the shell corporation, the Board believes that the purchasers of the debt securities could not, in good faith, lend without reliance on the margin stock as